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In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 1323

CONTINENTAL OIL COMPANY, ET AL., PETITIONERS

v.

FEDERAL POWER COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B, 1b-20b) is reported at 370 F. 2d 57. The opinion of the Federal Power Commission (J.A. 641-645) is reported at 32 F.P.C. 1167, and its order denying rehearing (J.A. 645-649) at 32 F.P.C. 1487.

JURISDICTION

The judgment of the court of appeals (Pet. App. B, 21b-22b) was entered on December 19, 1966, and the

order denying rehearing (Pet. App. B, 23b) on January 27, 1967. The petition for a writ of certiorari was filed on April 25, 1967. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r (b).

QUESTION PRESENTED

Whether the Commission properly treated certain transfers of gas leases as sales of natural gas subject to its regulatory jurisdiction.

STATUTES INVOLVED

Section 1(b) of the Natural Gas Act, June 21, 1938, c. 556, 52 Stat. 821, 15 U.S.C. 717(b), provides as follows:

> The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

The other pertinent statutory provisions are printed in Pet. App. A, 1a-5a.

STATEMENT

1. Petitioners (four producers of oil and natural gas who are referred to collectively as the "Catco"

group) obtained from the United States leases to explore for oil and gas in 10,000 acres in the "Ship Shoal" area off the Louisiana shore (Pet. 3, J.A. 90-121). Petitioners drilled 17 wells under these leases, resulting in 17 oil completions in 7 wells and 2 gas completions in one well. Gas was found in 46 reservoirs in 39 distinct sand zones, oil in 14 reservoirs in 8 distinct sand zones. (J.A. 3-5, 120, 121.)[1]

Petitioners then sold rights to produce oil and gas in an area comprising about 35 percent of the leasehold to two subsidiaries of Tennessee Gas Transmission Company[2] (J.A. 239-241, 307), this being the area believed to contain productive reservoirs (J.A. 31-32). The contract stated that the net recoverable reserves being transferred amounted to 533,333,333 Mcf of natural gas and 12,244,898 barrels of oil (J.A. 257).[3] Tennessee also acquired wells and equipment and the right to condensate and casinghead gas (J.A. 30), and an option, which it has exercised, to sell the oil produced from the leasehold to petitioners (J.A. 60, 580). In return, it agreed to pay petitioners $97,333,333, partly in cash and partly in notes that bore no interest (save in case of default) and were subject

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[1] Five reservoir sands that produced oil were also productive of gas (J.A. 25). Drilling on five potential gas wells was also begun but then was suspended "until some later date" (J.A. 5, 7).

[2] The purchasers are hereinafter referred to as "Tennessee".

[3] Provision was made for a redetermination of the reserves in the seventh year with a price adjustment upward or downward depending on whether they were found to exceed or to fall short of the estimated amounts (J.A. 257-258, 266-267). However, the price may not be reduced below $25 million (J.A. 273).

to accelerated payment should production of gas exceed specified quantities (J.A. 24, 35, 122-123, 252-259, 274). No gas is yet flowing from the transferred reserves (J.A. 46). The note installments continue to be paid (J.A. 47).

2. Tennessee applied to the Federal Power Commission for a certificate of convenience and necessity authorizing enlargement of its pipeline facilities to enable it to take and transmit the gas involved in the transaction. *Tennessee Gas Transmission Co.*, 30 F.P.C. 759, 762. During the course of this proceeding, Tennessee stated (30 F.P.C. at 765):

> The sole purpose for acquiring the leasehold interests in the Ship Shoal Field was to provide additional reserves and deliverability to meet the natural gas requirements of Tennessee's jurisdictional customers.

The examiner held that the Ship Shoal transaction with petitioners was a sale of natural gas to Tennessee in interstate commerce for resale, and hence "jurisdictional" (*i.e.*, subject to the Federal Power Commission's jurisdiction), and, on the merits, that the sale was not in the public interest because, *inter alia*, the gas would cost 28.3 cents per Mcf, far above the area ceiling[4] of 19.5 cents (30 F.P.C. at 801-809,

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[4] The "area ceiling" is the rate for an area fixed by the Commission, pending the outcome of area rate proceedings, to serve as a guide "in determining whether proposed initial rates [of independent producers] should be certificated without a price condition and whether proposed rate changes should be accepted or suspended." Statement of General Policy No. 61-1, 24 F.P.C. 818, 18 C.F.R. 2.56; Fourth Amendment, 26 F.P.C. 661.

819-821). On review of the examiner's decision, the Commission, while expressing agreement that the transaction was a jurisdictional sale, held that Tennessee's application should not be decided until a record could be made with respect to the jurisdictional question (as well as the public-interest question) in a proceeding in which the producers would be parties (30 F.P.C. at 764-767). Accordingly, the Commission issued an order to petitioners to show cause why they should not be found to be engaged in the jurisdictional sale of natural gas from the Ship Shoal field to Tennessee (J.A. 614-616; 30 F.P.C. 758), meanwhile deferring decision on Tennessee's application (30 F.P.C. at 767, 769).

3. After hearings in the show-cause proceeding, the Commission found that the Ship Shoal sale was jurisdictional and allowed petitioners an opportunity to make the necessary filings to bring them into compliance with the Natural Gas Act (J.A. 644, 648). The court of appeals affirmed this determination on the basis of this Court's *Rayne Field* opinion (*United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392).[5] It ruled that the Commission's findings, supported by substantial evidence, justified a conclusion that the Ship Shoal leaseholds were proven and substantially developed and hence that the transfer of those leaseholds constituted a sale under the Natural Gas Act (Pet. App. 12b, 15b, 16b-17b). The court stressed that (Pet. App. 16b-17b)

[5] This Court's *Rayne Field* decision was subsequent to the Commission's decision in the instant case but of course preceded the court of appeals' decision on review.

> Catco transferred a large volume of natural gas, definable within a range of reliable engineering estimates, to a jurisdictional pipeline company for imminent interstate transmission. The Commission's findings, supported by substantial evidence, lead us to the conclusion that Ship Shoal was 'proven and substantially developed' under the standards of *Rayne* and *Bastian Bay*.[6]

The court found no conflict between the Outer Continental Shelf Lands Act of 1953 (OCSLA), 43 U.S.C. 1331-1343 (Pet. App B, 3a-5a), governing the development of offshore resources, and the Natural Gas Act. It rejected petitioners' argument that OCSLA repealed the Gas Act in favor of Louisiana State law (which does not recognize a sale of gas in place), noting that OCSLA adopts State law only if "not inconsistent * * * with other Federal laws" (Pet. App. 18b).

ARGUMENT

In the *Rayne Field* case (*United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392), this Court held that sales of leasehold interests which resulted in the transfer of large amounts of natural gas to an interstate pipeline for resale in other States were properly treated by the Commission as jurisdictional sales of natural gas. In the present case,[7] the court

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[6] *Bastian Bay (Federal Power Commission* v. *Pan American Petroleum Corp.*, 381 U.S. 762) was a companion case to *Rayne Field*, that this Court decided in a *per curiam* order in reliance on its *Rayne Field* opinion.

[7] The case at bar is the last of five major efforts to avoid regulation by the Commission by the device of a sale of lease-

of appeals concluded (Pet. App. 12b-17b, 20b) that the sale of the Ship Shoal leaseholds was an essentially similar transaction.[8] The court emphasized that the economic effect of the Ship Shoal sale was not materially different from that of a conventional sale of gas (Pet. App. 11b) and that Tennessee's intention to connect the Ship Shoal reserves to its interstate transmission system demonstrated that the sale was in interstate commerce (Pet. App. 17b-18b).

Petitioners, pointing to this Court's observation in the *Rayne Field* case (381 U.S. at 403) that the degree of development is a relevant consideration in determining whether sale of a leasehold interest involves

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hold interests, the others being *Rayne Field* and *Bastian Bay, supra*, and *MCN* and *King Ranch*. In *MCN*, the examiner denied the purchaser's application for a certificate authorizing the necessary taking facilities, and the parties then entered into a conventional sale of gas. *Tennessee Gas Transmission Co.*, 29 F.P.C. 4. In *King Ranch*, the sequence was the same: denial of a certificate by the examiner (*Columbia Gulf Transmission Co.*, 30 F.P.C. 831) followed by substitution of a conventional sale of gas (see *ibid.*). The producers in *Rayne Field* have now filed an application for a certificate of public convenience and necessity authorizing the sale of the leaseholds to Texas Eastern Transmission Corporation, the original purchaser. The Commission has not yet acted on the application.

[8] The court noted a number of specific respects in which the Ship Shoal transactions resembled those in *Rayne Field* and *Bastian Bay*: notes payable over 16 years, with an acceleration clause geared to production; intermediate corporate structures to shield the pipeline companies from principal obligation on the notes; and provision for future redetermination of the gas reserves and corresponding price revisions (Pet. App. 11b). All these factors indicate, of course, that the pipeline purchaser was not really assuming the risks of production; that, realistically viewed, it was purchasing gas.

a jurisdictional sale of gas, argue that development of the Ship Shoal field was not sufficiently substantial for this purpose. This essentially factual issue does not merit further review. The court below did not hold that every sale of a leasehold is a jurisdictional gas sale. Rather, it carefully examined the circumstances of the particular transaction—noting especially the purchaser's intention to sell gas from the reserves as soon as it obtained the Commission's approval for the necessary transportation facilities[9]—and properly concluded that there was sufficient development of the leaseholds to meet the *Rayne Field* test (Pet. App. 14b, 15b, 16b-17b).

Nor is there any merit to the suggestion that the Outer Continental Shelf Lands Act (OCSLA) makes Louisiana law (which does not recognize a sale of gas in place) applicable to the Ship Shoal sales. Section 4(a)(1) of that Act (Pet. App. B, 3a) expressly extends the "laws * * * of the United States"—including of course the Natural Gas Act—to the offshore region "to the same extent as if" it "were an area of exclusive Federal jurisdiction located within a State." And Section 4(a)(2) (Pet. App. B, 3a) provides that the laws of the adjacent States are to apply only "to the extent * * * not inconsistent with * * * other Federal laws." Louisiana's non-recognition of a sale of gas "in place" is inconsistent with the Natural Gas Act as interpreted by this Court in *Rayne Field*, and

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[9] As noted in the Statement, *supra*, p. 5, consideration of this application has been delayed pending final decision of the jurisdictional issue (*Tennessee Gas Transmission Co., supra*, 30 F.P.C. at 764-767).

is accordingly without force (Pet. App. 18b-20b). Moreover, nothing in the text or history of OCSLA suggests even remotely an intention to affect the federal regulation of sales by natural gas producers.[10]

[10] Petitioners' argument that the Commission, if it has jurisdiction here, could nullify the authority of the Secretary of the Interior in approving the transfer of the leaseholds by denying petitioners a certificate proves too much. For the same result would follow from the Commission's refusal to issue to Tennessee, the purchaser, a certificate for the construction of the facilities necessary to take the Ship Shoal gas—and the Commission's authority under Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c) (Pet. App. A, 1a), to require such a certificate is unquestioned. Petitioners also complain that if the transaction is construed as a conventional sale, "with the products treated as 'production'", they will immediately become liable for a royalty of 1/6 of the value of the products sold (Pet. 17, n. 25). But the royalty is payable only on actual production (J.A. 93-94, 108-109). There is no basis for equating the sale of the reserves with the commencement of actual production; they are two quite different parts of the process of getting the gas from the ground to the burners.

CONCLUSION

Viewed in the light of this Court's recent *Rayne Field* and *Bastian Bay* decisions, the petition for a writ of certiorari presents no substantial question; it should therefore be denied.

Respectfully submitted.

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